DOCUMENT RESUME

ED 432 177 HE 032 149

TITLE	Interim Budget Plan.
INSTITUTION	Office of Student Financial Assistance (ED), Washington, DC.
PUB DATE	1999-04-05
NOTE	42p.
AVAILABLE FROM	Department of Education, Office of Student Financial Assistance, 400 Maryland Avenue, SW, ROB-3, Washington, DC 20202-5132.
PUB TYPE	Reports - Descriptive (141)
EDRS PRICE	MF01/PC02 Plus Postage.
DESCRIPTORS	*Budgets; Federal Legislation; Grants; Higher Education; Performance Factors; *Program Budgeting; *Public Agencies; *Student Financial Aid; *Student Loan Programs
IDENTIFIERS	Family Education Loan Program; Federal Direct Student Loan Program; *Higher Education Act Title IV; *Office of Student Financial Assistance

ABSTRACT

This report provides the interim budget plan of the U.S. Department of Education's Office of Student Financial Assistance (OSFA) for fiscal year 2000. It reviews factors influencing OSFA's budget request, including legislative requirements, recent accomplishments, the need to maintain both the Direct Loan and Federal Family Education Loan programs, near-term challenges (such as the improvement of customer service, reduction in the overall cost of delivering student aid, and the transition to a performance-based organization), increased workload projections, and the potential impact of Title IV costs. The report then discusses OSFA's interim budget request, focusing on the funding of basic operations and investments to support the transition to a performance-based organization. Two appendixes provide a description of automated data processing activities and OSFA obligations by object classification. (MDM)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

ED 432 177

Interim Budget Plan

Office of Student Financial Assistance

We help put America through school

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)
✓ This document has been reproduced as received from the person or organization originating it.
☐ Minor changes have been made to improve reproduction quality.
• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

April 5, 1999

HE032-1419

BEST COPY AVAILABLE

Interim Budget Plan
Office of Student Financial Assistance

Introduction

With strong bipartisan support, the Higher Education Amendments of 1998 called for the establishment of the Federal government's first Performance-Based Organization (PBO), the Office of Student Financial Assistance (OSFA), reporting directly to the Secretary of Education. The PBO was given increased operating flexibility and chartered to improve customer service, reduce cost, and integrate its computer systems. Within a few weeks of the legislation being signed by the President, the Department had reorganized to put the PBO in place and provide it with transition administrative support.

Mission

The mission of OSFA is **to help put America through school.** We provide over $50 billion in Federal grants and loans annually to help students and families pay for college education and postsecondary training. Our **overall standard** is to do that job well enough—both in service delivery and in financial management—**to equal the best in the business.**

Challenges

To reach this standard of performance, and satisfy the intent of the PBO legislation, we must make huge changes in our business processes, computer systems, and organization. Four basic operating principles will guide how we make these changes:

- One – be obsessed with our customers: students;

- Two – constantly collaborate with partners: schools, lenders, guaranty agencies, and other organizations that help deliver aid to students;
- Three – re-engineer and align everything (business processes, computer systems, and organization) to support performance objectives;
- Four – adopt a financial management system that achieves the best in business standards.

Even while we make this transformation, we must continue to deliver current services and manage our $150 billion loan portfolio without missing a beat. These often-conflicting requirements for change and the maintenance of current services have to be met while the workload — for example, the number of applications for aid and the size of both the FFEL and Direct Loan portfolios — grows dramatically over the next several years.

Budget

The Administration's FY 2000 Budget includes a total of $662 million in mandatory and discretionary funds for OSFA operations in the next fiscal year, an increase of $116 million over the FY 1999 level. Nearly 85 percent of these funds are already provided under authorizing legislation for the administration of the Federal government's two principal student loan programs. (The FY 2000 Budget also includes an additional $180 million in mandatory funding for statutorily required account maintenance fees to guaranty agencies.)

Of absolute necessity, we will use most of our funds in both FY 1999 and FY 2000 to maintain current services without interruption to students, institutions, and financial partners, and to service

loans in repayment status. But creating a PBO that can handle the increasing workload with better customer service, with the tools it needs to reduce costs, and with modern integrated computer systems requires immediate investment. We are allocating $47 million in FY 1999—9 percent of our total operating funds—and $74 million in FY 2000—11 percent of the total FY 2000 budget request—for these investments.

The rest of this budget plan has two major sections:

- **Factors that influence OSFA's FY 2000 Budget**, including new legislative requirements, immediate challenges being addressed in OSFA's interim performance plan, and long-term considerations.

- **OSFA's Budget Request,** where we describe how resources will be allocated in both FY 1999 and FY 2000 to maintain basic operations and also make the investments needed to establish the PBO and to begin the improvements required of it.

A brief concluding section adds a perspective on the adequacy of the FY 1999 and FY 2000 funding levels and budget needs over the long term. While the FY 1999 and FY 2000 levels will launch the PBO, the outlook for FY 2001 through 2004 is less clear since resource levels in the President's Budget—most of which were set in the Higher Education Amendments of 1998— remain flat despite dramatic increases in workload. To ensure that the future budget structure can support the OSFA's ability to meet ambitious performance goals as workload rises, Congress and the Administration may want to consider alternative funding approaches that link funding to workload, using unit cost benchmarks.

FACTORS INFLUENCING OSFA'S FY 2000 BUDGET

In developing our FY 2000 budget, we took into account a wide range of factors, including—

- Legislative requirements in recent authorizing legislation establishing OSFA as a performance-based organization;
- Recent accomplishments that the new organization can build on;
- The need to maintain two healthy loan programs, consistent with congressional and administration policy;
- Near-term challenges, that are addressed by our interim performance plan for FY 1999;
- Increases in projected workload over the next five years, in the face of a constrained administrative budget; and
- Potential impact of our operations on the total costs of Title IV program delivery, including losses from defaults, fraud and error; and administrative costs of schools, lenders, and guaranty agencies that ultimately affect taxpayer costs.

Legislative Requirements

Under the Higher Education Amendments of 1998, OSFA is responsible for managing the operational functions supporting the Title IV programs. It is guided by a Chief Operating Officer (COO) who reports directly to the Secretary of Education.

OSFA's purposes generally are to improve service to our customers while keeping down costs. The tools we are using include increased accountability of program managers combined with greater management flexibility, as well as integrated information systems.

On December 7, 1998, Greg Woods was sworn in as COO for OSFA. Under the law, the Secretary and the COO must agree on, and make available to the public, a performance plan for the PBO for the succeeding five years that establishes measurable goals and objectives for the organization. This plan must be developed in

consultation with stakeholders, including: students; institutions of higher education; Congress; financial partners; the Advisory Committee on Student Financial Assistance; and other interested parties.

We will complete the first five-year performance plan by the end of FY 1999. For the 1999 start-up period, the Secretary and the COO have agreed on an interim performance plan to guide the PBO transition through the end of this fiscal year. This budget plan incorporates the performance objectives included in the interim plan. We will develop a five-year budget at a later date to support the five-year performance plan.

The Department's Recent Accomplishments: Setting the Stage

Recent years have seen major improvements in student financial aid operations, even as the volume of Direct Loan and other transactions has grown dramatically. Most of these accomplishments preceded the creation of the PBO. They include:

- The Direct Loan program was established and grew from roughly 7 percent of overall loan volume and 300,000 borrowers in its first year, FY 1994, to roughly 35 percent of all loans for the current academic year (1998-1999). Through FY 1998, the program made over $30 billion in loans to roughly 4 million borrowers; by the end of FY 2000, these figures are expected to rise to almost $60 billion and 6 million borrowers.

- The cohort student loan default rate has dropped for 6 consecutive years, to an all-time low of 9.6 percent. In addition, collections on defaults have more than doubled—to over $2 billion a year—over the same period.

- Our institutional oversight activities have been thoroughly redesigned to focus resources on the highest risk schools, better coordinate regional and headquarters staff activities, and institute a case management approach that allows us to identify and resolve school problems more promptly.

- The National Student Loan Data System (NSLDS) is now operational, offering a centralized data base to verify student eligibility, calculate institutional default rates, and facilitate program audits and other accountability measures for the first time in the over-30-year history of the student aid programs. Since 1994, eligibility checks performed through NSLDS have identified defaulters applying for additional financial aid, preventing the award of over $1 billion in loans and grants to ineligible students.

- For the first time ever, the Department received an unqualified opinion on its audited financial statement. This "clean" audit opinion for FY 1997 was due in large part from improved data collection and management in the Federal student loan programs.

- Less than two years ago, we temporarily suspended accepting loan consolidation applications because we couldn't keep up with demand. Now, with a reinvented approach we are processing a much greater volume and maintaining an average turn-around time of 60 days or less.

- We have saved millions of dollars by restructuring our major systems contracts to centralize processing activities at a single, cost efficient data center. Processing under a number of major contracts—including NSLDS and the Pell Grant and Campus-Based Aid systems—has already been shifted to this center; all our processing activities will be transferred to the center by the end of FY 2000.

- Two years ago, none of our 14 mission-critical systems had begun renovation to avoid Y2K meltdown. Now, all have been renovated, validated, and put in operation ahead of the Office of Management and Budget's (OMB) March 31, 1999, deadline.

- Students can now file applications for Title IV student assistance over the Internet, which saves them time, reduces errors, and cuts processing costs.

- Working with the FFEL community, we are implementing a master promissory note for both Direct and FFEL loans beginning in academic year 1999-2000. This will streamline the loan delivery process by eliminating, for most schools and borrowers, the need to execute a separate promissory note every year a student borrows.

Need to Maintain Two Healthy Loan Programs

With the recent reauthorization of both the Direct Loan and FFEL programs, Congress and the Administration agreed to continue the healthy competition that has stimulated significant improvements in the student loan industry. The creation of the Direct Loan program, with its streamlined administrative processes, led lenders and guaranty agencies to simplify their own processes, offer new services, and introduce greater price competition.

Currently, about one-third of total student loan volume ($11.4 billion in FY 1999) is made through the Direct Loan program administered by the Department, and two-thirds ($20.9 billion) is made by private lenders under the Department's FFEL program. These relative proportions are expected to remain stable over the next several years.

We — the PBO and the Department, supported by the Administration — are committed to improving the administration of both loan programs, in ways that will continue the benefits that competition provides for schools, students, and taxpayers. For FFEL, we will work with guaranty agencies and lenders to use the new HEA authority for Voluntary Flexible Agreements to test promising approaches to improving operations and reducing costs. In redesigning our internal systems, we will work with lenders and guaranty agencies to improve the quality and accessibility of data that lenders, guaranty agencies, and OSFA need to manage the loan programs more effectively. We will also re-examine administrative requirements that may unintentionally stymie competition and improvements in the FFEL program.

For Direct Loans, we will continue to invest in administrative systems to keep up with growing portfolio volume and to improve the quality of services to schools and students. To the extent possible, within current law and budgetary constraints, policy officials within the Department will establish competitive terms for Direct Loans.

No agreement has been reached to date on a methodology for comparing the true costs of the two loan programs to taxpayers. A recent Inspector General report on administrative costs in Direct Loans and FFEL re-ignited the controversy over this issue. A simple comparison is difficult, since the significant administrative costs of Direct Loans are financed entirely by the Department. The Department pays only a small portion of FFEL administrative costs from its direct appropriations. Most FFEL operating costs are borne by lenders and guaranty agencies, who receive statutorily determined subsidy payments to ensure profitability.

Congress established a methodology in 1995 for comparing the costs of the two programs by incorporating certain Direct Loan administrative costs into the subsidy costs of the Direct Loan program. Using that methodology, under current economic conditions and new statutory formulas enacted in the Higher Education Amendments of 1998, the Department estimates that total Federal costs for every $100 of Direct Loans in FY 1999 will be $7 cheaper than for the same amount of guaranteed loans. Alternative methodologies and interest rate assumptions will produce somewhat different estimates.

Political debates are likely to continue about the true costs of the two programs as well as possible future structural changes in the loan programs to drive down unnecessary costs. OSFA can help inform these discussions by developing reliable financial information on administrative and program costs to help guide policy decisions. In the meantime, continued competition between Direct Loans and FFEL will likely produce benefits for both schools and students. Accordingly, our goal is to maintain two healthy programs.

Near-term Challenges Addressed by OSFA's Interim Performance Plan

Our interim performance plan—a performance contract between the Secretary and OSFA to cover operations until September 30, 1999—lays the foundation for transforming OSFA into a performance-based organization. The interim plan sets forth these overall performance objectives—

- Improve customer satisfaction;
- Reduce the cost of delivering student aid; and
- Transform the Office of Student Financial Assistance into a PBO.

To assess progress over the next six months, we have identified measurable indicators of success for each objective. In brief, this is how we'll satisfy each objective:

- **Improve Customer Service** – While maintaining the current level of overall customer service, OSFA will improve targeted areas through efforts such as increasing electronic filings and introducing new Internet-based electronic services, placing greater emphasis on technical assistance and training, and providing a single point of contact to our customers.

- **Reduce the Overall Cost of Delivering Student Aid** – As we begin a multi-year campaign to reduce the cost of delivering Title IV aid, OSFA will identify those operational improvements that would have the greatest impact on costs. Cost baselines will be developed, and financial systems will be improved to accurately measure and track these costs over time. We will also look closely at how to reduce unit costs for our major transactions.

- **Make the Transition to a PBO** – To transform the Office of Student Financial Assistance into a high performing organization—equal to the best in business—OSFA is closely examining high performing organizations to benchmark their processes, systems, and employee performance. OSFA also established a Customer Service Task Force of key managers and front-line staff that will deliver recommendations in July 1999 for specific, top-to-bottom improvements in customer satisfaction and service. In consultation with its external partners, OSFA is developing a modernization blueprint to guide the re-engineering of its systems in the coming years. Working with employees, OSFA will develop a Human Resource and Organizational Plan to ensure staff can meet the high performance standards of the PBO.

The activities carried out during this transitional period will inform the development of our five-year plan, which we will complete by September 30, 1999. This plan may include recommendations for additional legislation or changes to our budget structure if the Secretary and the COO determine such changes are necessary for OSFA to meet its performance goals.

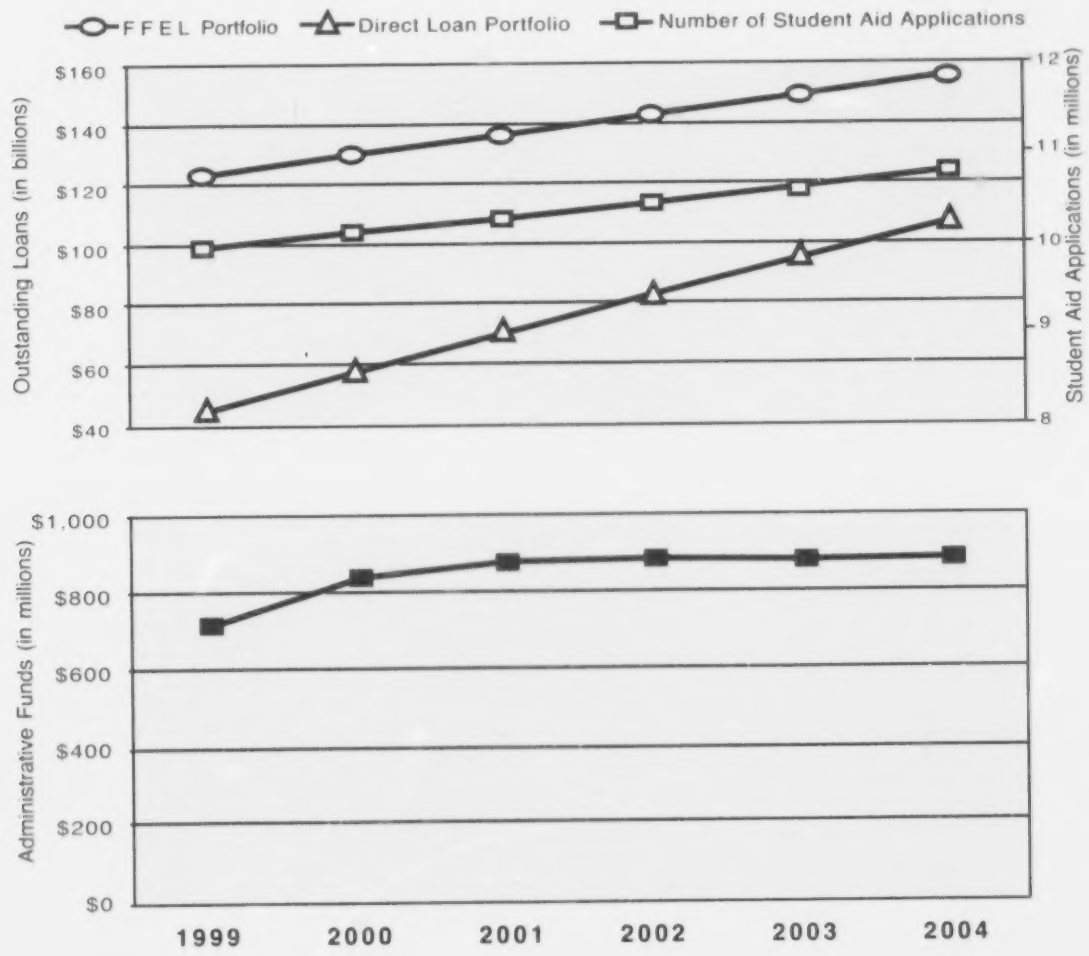
In the same way that major corporations report to investors on their performance, we will report regularly to Congress and the public on our performance. Beginning July 1, 1999, we will issue quarterly reports on our progress in achieving all objectives in our performance plan. This information will be available to the interested public over the Internet.

We will develop baseline measures of performance and cost efficiency for inclusion in the five-year plan this September. Subsequent quarterly reports will indicate our progress against those baselines. Where we can appropriately benchmark our performance against other government or private sector entities, we will include those comparisons also.

A combination of rapidly expanding workload and capped administrative funding underscores the urgent need to increase the efficiency and cost-effectiveness of our operations (See Exhibit 1). Over the next five years, our management responsibilities will grow dramatically. While Direct Loans are expected to continue to account for roughly one-third of annual new loan volume, the addition of new cohorts of students each year will increase the overall Direct Loan portfolio by more than 84 percent—to almost $60 billion and more than 6 million borrowers—between FY 1998

Increased Workload Projections

Exhibit 1:
OSFA Workload Measures
and Administrative Funding



and FY 2000. The portfolio will more than double by FY 2004, and will continue to increase dramatically in subsequent years until substantial numbers of Direct Loan borrowers finish repaying their loans. Servicing this rapidly expanding portfolio represents OSFA's single largest administrative cost. The more mature FFEL portfolio will grow by more than 26 percent during the same period, to over $150 billion. (These workload projections are based on an analysis of historical data; they are generally consistent with estimates developed by the Congressional Budget Office.)

Our major expenses—such as Direct Loan origination and servicing, student aid application processing, and payment processing in the FFEL program—are largely driven by the volume of work to be done. Administrative funding to support these activities in the future, however, is not linked to workload. The President's FY 2000 Budget includes funding levels set in the Higher Education Amendments of 1998, under which Section 458 funds to support OSFA administrative activities increase by $45 million—to $600 million—from FY 2000 to FY 2001, and are straightlined thereafter. One of the greatest challenges facing OSFA will be handling the large increases in workload within the statutory resources available for FY 2001 and beyond.

Potential Impact on Total Title IV Operating Costs

Our operations comprise only about 4 percent of the total Federal expenditures on Title IV programs, as illustrated in Exhibit 2. But our operations have a significant impact on the broad array of costs associated with the total Title IV system. Protection of Federal financial interests requires us to make strategic investments in administrative activities to ensure that:

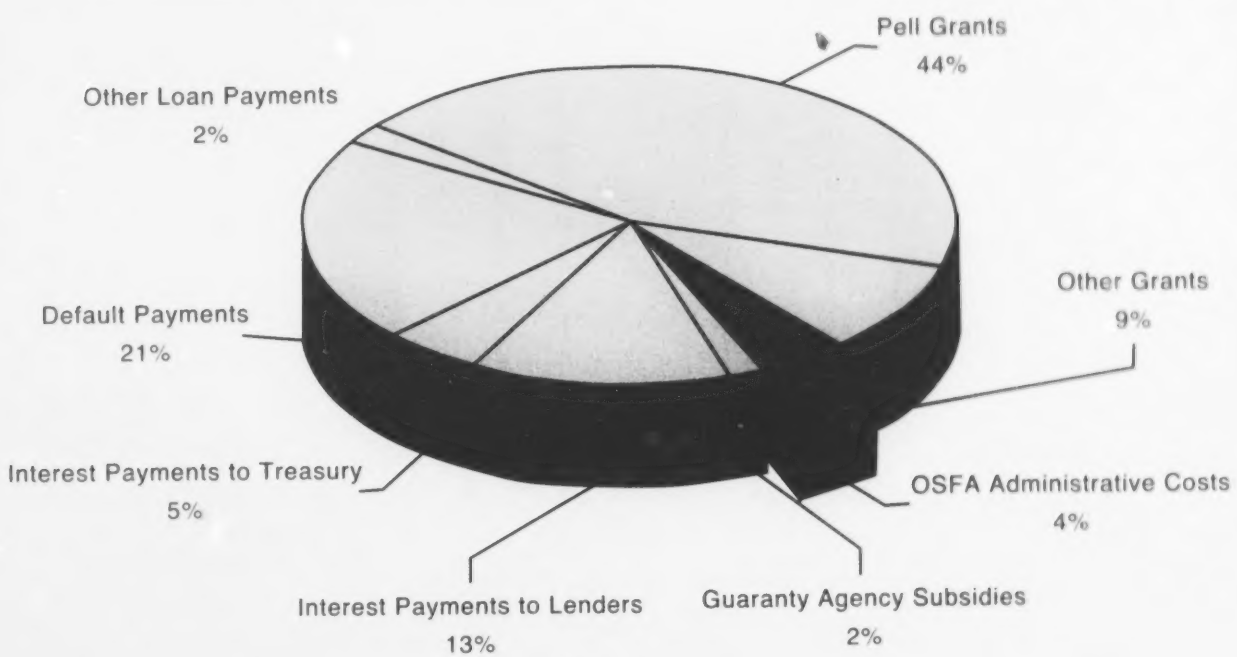
- we deliver funds in the right amounts, on-time, to intended beneficiaries;
- participating schools and financial institutions have the capability to manage Federal dollars appropriately, and that all participating schools comply with Federal laws and regulations;

- we manage the guaranteed and Direct Loan programs effectively to minimize default costs; and
- we continually improve service and cost-efficiency to minimize unnecessary costs to us and our partners.

We oversee the delivery of Federal financial aid to students and their parents through a complex, integrated system that includes over 4,000 lenders, 36 guaranty agencies, over 6,000 schools, participants in the student loan secondary market, and other organizations. We have created processes for applying for aid; delivering funds to students, schools, and lenders; determining individual and institutional eligibility; originating and servicing Direct Loans; and tracking the status of over 60 million outstanding loans, among other functions. Changes in any part resonate throughout the entire system.

In achieving our ambitious performance goals, we must take into account the interrelationships of these systems. Together, lenders,

Exhibit 2:
Federal Student Aid Costs - FY 2000



guaranty agencies, schools, and the Federal government will spend over $20 billion in FY 2000 to support programs authorized under Title IV of the Higher Education Act.

Several major cost components of the Title IV system, other than Federal administrative costs, can be directly affected by our operations, as described below.

Federal grant and loan funds—Department of Education programs will provide more than $10 billion in need-based grant aid in FY 1999 to nearly 4 million students; Federal Pell Grants alone will total over $7 billion in awards. An additional $32 billion in student loans (excluding loan consolidations) made with Federal capital or private capital and Federal guarantees against default will be awarded in FY 1999. We expect this amount to rise to $45 billion by FY 2004.

The complex array of Federal programs and rules can be very daunting for many students and families. We want to help people find the aid that they are eligible for and understand the obligations they create for themselves when they accept aid. For example, OSFA and our FFEL partners are working with schools to create software that can serve as an electronic "entrance and exit counselor" to student aid applicants and borrowers leaving school.

Federal funds to cover default losses—Despite dramatic reductions in student default rates over the past five years, defaults on student loans made in FY 1999 will still cost the Federal government nearly $7 billion. Of the roughly $170 billion in total outstanding student loans, approximately $20 billion is currently in default. These default losses occur despite efforts by institutions, financial partners, and the Department to help borrowers manage their loan burden. Default costs for Federal student loans are understandably higher than for many other Federal and private loan programs, since there is inherent risk in the program's mission of making loans

available to all students, without collateral, at a stage in their lives when most cannot demonstrate ability to repay.

A substantial portion of these losses are recouped through collection efforts by guaranty agencies and our highly regarded debt collection program. The Debt Collection Service assigns defaulted loans to private collection agencies under competitive performance-based contracts when guaranty agencies have been unsuccessful in bringing loans into repayment. Nonetheless, in today's economy, default costs can be further reduced through sound management of the loan programs by OSFA, Title IV schools, and our financial partners. These efforts include:

- More effective borrower counseling, to ensure borrowers understand how debt levels affect their repayment obligations, and the various repayment options available to them. Studies indicate that borrowers who are aware of loan terms and repayment options are significantly less likely to default.

- Loan servicing that takes advantage of recent advances in the consumer loan industry, using automated risk management techniques to identify the most appropriate servicing strategies for different types of borrowers.

- Partnerships between guaranty agencies, OSFA, and private collection agencies to share successful strategies and determine the best time for guaranty agencies to turn problem loans over to the Department.

Administrative costs incurred by schools, guaranty agencies, and lenders. By even the most conservative estimates, schools, lenders, and guaranty agencies spend more than $1 billion each year to help administer the Federal student aid programs. Definitive data of these non-Federal costs are not available; estimates range as high as $3 billion annually. Spending supports a range of activities:

- Lenders originate and service guaranteed loans;
- Guaranty agencies track individual loan guarantees, work with lenders and borrowers to avoid defaults, review and pay lender default claims, and collect on defaulted loans;
- Schools process student aid applications, develop individual student aid packages, counsel students, and administer campus-based aid programs such as Federal Work-Study and Perkins Loans.

The nature and expense of each of these activities is—to varying degrees—driven by our systems and requirements. Re-engineering our business processes and the systems that support them, and taking full advantage of the World-Wide Web and other technologies, will streamline processes and ultimately reduce administrative costs for us and our partners. During the development of our blueprint for modernizing our computer systems, we are consulting with these partners to ensure we properly define business requirements, eliminate redundant processes, and sequence changes to result in improved service and reduced costs in the overall system.

Across all these discrete cost components, OSFA has a fundamental responsibility to the Federal taxpayer to ensure that Title IV funds are spent wisely and well. The effective stewardship of this multi-billion-dollar investment in America's future can also be enhanced through system and process improvements. For example, the Department championed an initiative, later enacted by Congress, to allow the verification of applicant income against taxpayer data held by the Internal Revenue Service (IRS). The need for this change was documented by an Inspector General study, based on a test match between OSFA and the IRS, that estimated at least $100 million in overawards had been made in academic year 1995-1996 to students who misreported their income. OSFA is working with the IRS to explore ways to verify parent and student incomes, as was authorized in the recent HEA amendments.

OSFA's BUDGET REQUEST

We will spend the bulk of our resources in FY 1999 and FY 2000 on maintaining current services without interruption. With careful management, sufficient resources will be available in both years ($47 million in FY 1999 and $74 million in FY 2000) for us to begin addressing our other major challenges. The near-term focus will be on making the transition to a performance-based organization, including developing the blueprint for modernizing computer systems.

In developing the five-year plan, we will draw on the recommendations of the Customer Service Task Force and the blueprint for modernizing computer systems to firm up our FY 2000 budget estimates. These two products will also put us in a better position to assess the resource requirements associated with increasing workload and our efforts to control Title IV costs.

The President's FY 2000 Budget for OSFA operations would provide $662 million under three funding sources:

- $555 million from a mandatory appropriation provided under Section 458 of the Higher Education Act, which finances loan administration costs for FFEL and Direct Loans. (This amount excludes $180 million for guaranty agency account maintenance fees that are also financed by Section 458.)

- $48 million for FFEL administration, a discretionary account, which finances some of those FFEL costs not paid for under Section 458.

- $59 million from the discretionary Program Administration account, for general program management and administration of Title IV grant programs. (This is our portion of the Department's central administrative account funding most salaries and expenses of the Department.)

A complete list of these funds by object classification is provided in Appendix B, beginning on page 34. These amounts exclude $40 million for loan-related activities (primarily debt collection activities) that are financed under the Direct Loan and FFEL program subsidy accounts.

The total FY 2000 budget includes a $116 million increase over FY 1999, of which $115 million is provided under the mandatory Section 458 appropriation, to support the growing loan volume under the Direct Loan and FFEL programs. Outstanding Direct loan volume will increase from $46 billion to nearly $60 billion between FY 1999 and the end of FY 2000, and the total borrowers in repayment will increase from 5 million to 6 million. Outstanding FFEL volume will increase from $124 billion to over $130 billion between FY 1999 and FY 2000.

Of the total budget for FY 2000, $588 million (89 percent) is to continue essential operations and $74 million (11 percent) is for necessary investments to modernize OSFA systems to enable future reductions in unit costs and to expedite the transition to a customer-focused, performance-based organization. In FY 1999, $499 million (91 percent) is for basic operations and $47 million (9 percent) is for new investments supporting OSFA's interim performance plan.

Exhibit 3: Student Aid Administrative Spending By Activity - FY 1999-2000 (In millions of dollars)

	1999		2000	
	Spending	Percent of Total	Spending	Percent of Total
Direct Loan Servicing/Origination	$187	34%	$265	40%
Other ADP Systems	138	25%	142	21%
Subtotal, ADP	325	60%	407	61%
Personnel Costs	91	17%	96	15%
Other OSFA Activities	34	6%	36	5%
Other Offices	49	9%	49	7%
Subtotal, Operations	499	91%	588	89%
Modernization Initiatives	47	9%	74	11%
Total Costs	546	100%	662	100%

Funding for Basic Operations

Our operating costs for FY 1999 and FY 2000 are divided among three major categories.

Financial Assistance Delivery. We will spend $407 million in FY 2000—or 62 percent of our overall budget—on private-sector data processing contracts to originate and service Direct Loans, process applications for student aid and payments to students, schools, guaranty agencies, and lenders, and collect defaulted loans. The costs of the largest of these contracts are driven by workload volume; without substantial system changes, the cost of these contracts will nearly double between FY 1999 and FY 2004. Over the same period, Direct Loan originations will increase by 38 percent, Direct Loan borrowers in servicing will double, and applications for financial aid will rise by 8 percent. Modernization activities will focus on these areas. (Detailed information on contract spending is provided in Appendix A, beginning on page 29.)

Personnel Compensation and Benefits. Overall personnel compensation and benefits costs will increase by $5 million from FY 1999 to FY 2000, from $91 million to $96 million. Staffing levels are expected to remain steady at 1,285 (including 32 non-OSFA positions that support the student aid programs); the increase in costs reflects built-in factors such as the 1999 pay increase, the proposed government-wide 4.4 percent Federal pay increase scheduled for January 2000, and growth in the Federal cost of employee benefits.

Postage, Printing, and Other Support Activities. Beyond data processing contracts and staff costs, student aid operations costs include postage, printing, rent, and travel. This spending, which increases from $83 million in FY 1999 to $85 million in FY 2000, is split between OSFA and other Department support offices. It is not expected to increase substantially in future years. Savings in this area will be realized from process re-engineering, such as reducing printing and postage costs through increased electronic communications.

Investments to Support the PBO Transition

As noted above, OSFA has earmarked $47 million in FY 1999 and $74 million in FY 2000 to support a range of modernization initiatives (see Exhibit 4). These activities include:

Implementing Modernization Blueprint. Currently the delivery and management of Title IV assistance is largely carried out under 14 systems operated by 8 separate contractors. This costly and cumbersome stovepipe structure evolved over many years, reflecting the highly complex web of transactions and participants involved in delivering Federal student aid. (See Exhibit 5 on page 21.) Re-engineering the business processes, and designing an integrated, user-friendly system to support them, is a high priority of Congress and the Administration.

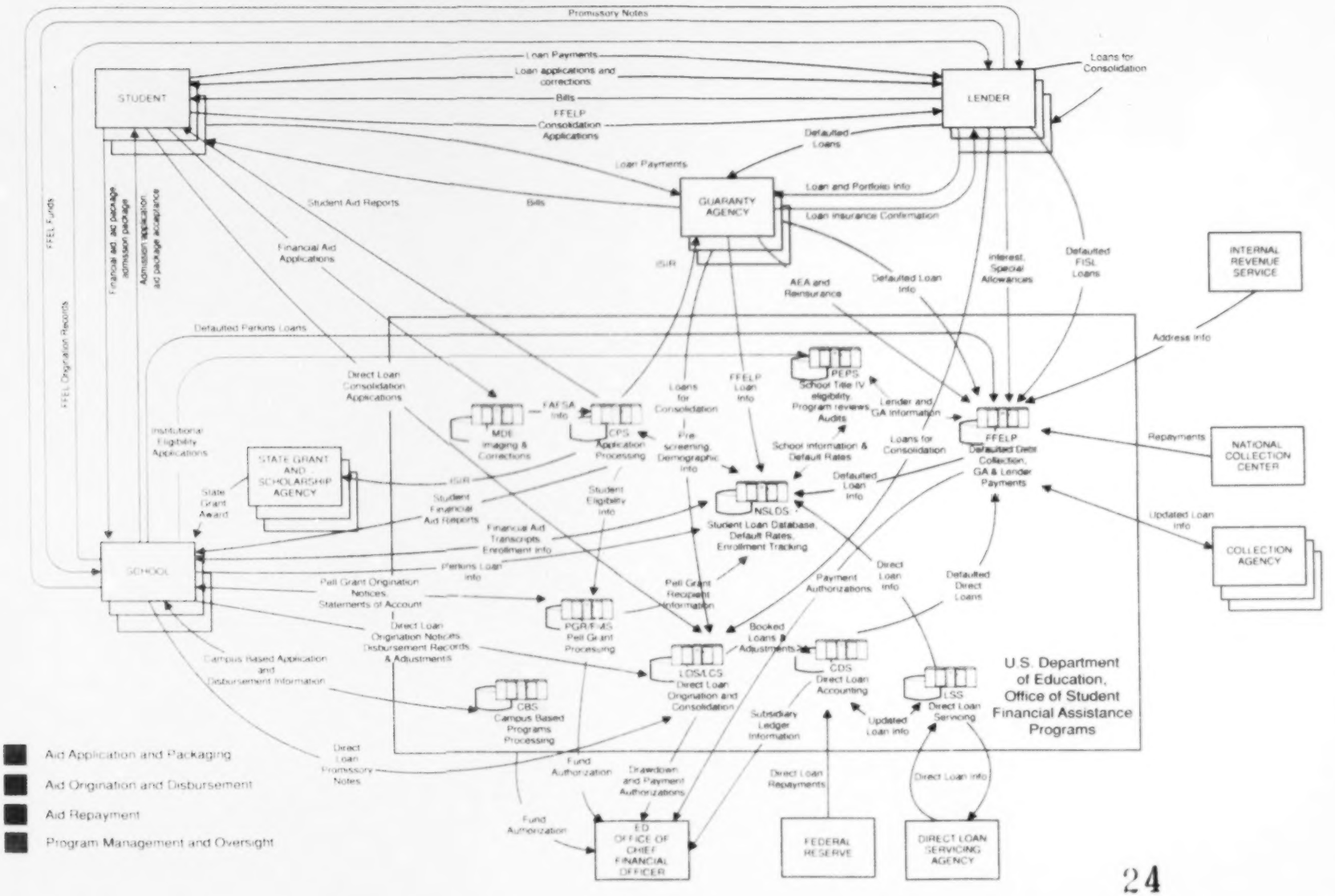
Exhibit 4: Planned OSFA Initiatives - FY 1999-2000 (In millions of dollars)

	1999	2000
Implementing Modernization Blueprint	$24.0	$38.0
Enhanced Financial Management	8.0	8.0
Human Resources Plan	1.5	1.5
Facilities Improvements	8.0	12.0
Staff Training	1.3	2.7
Title IV Omsbudsman	1.2	1.8
Customer Service Task Force Recommendations	3.0	10.0
Total Costs	47.0	74.0

A number of modernization activities are already underway:

- Consolidation of OSFA's data center operations in a single location, under a single contract with Computer Sciences Corporation;
- Voluntary pilot projects, such as Access America for Students, CSU Mentor, and Colorado Pepper, which test new ways to deliver electronic services to students.

Exhibit 5: The Federal Student Financial Assistance Delivery System



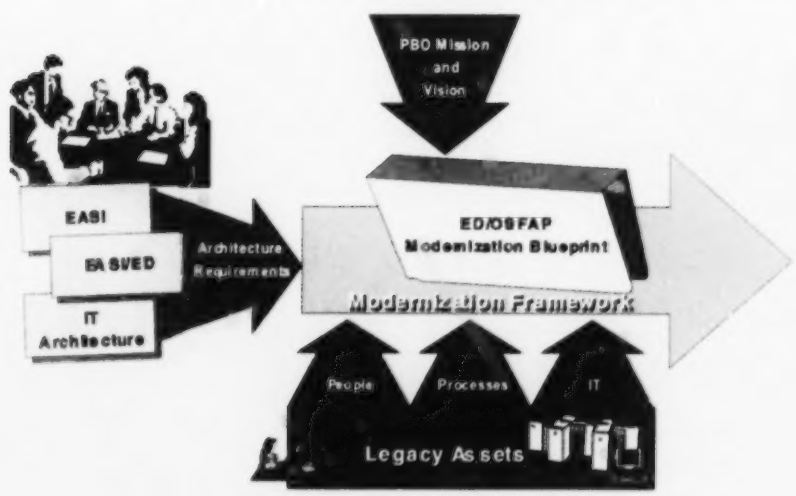
BEST COPY AVAILABLE

- New services and improvements being incorporated into existing contractor systems. This includes enhancing student Internet access to Title IV services, such as applying for a consolidated loan or accessing loan information in the National Student Loan Data System. To provide timely and user friendly information to schools, a new Pell Grant Recipient Financial Management System is being implemented, supporting pilots of just-in-time funding.

All these efforts support Project EASI (Easy Access for Students and Institutions), a collaborative effort between the Department of Education (EASI/ED) and Title IV program participants to redesign the current cumbersome and costly systems. By using new technology and electronic data exchange now in use by the financial industry, Project EASI's intent was to create an integrated, student-focused delivery system that provided students and Title IV delivery partners with ready access to program information they need.

To bring together EASI and other planned OSFA modernization activities into a coherent framework, we are now working to complete by July 31, 1999, a modernization blueprint for all the Title

Exhibit 6: Building A Modernization Blueprint



IV information technology (IT) systems (see Exhibit 6). This effort will document all major business requirements and systems, and provide a sequenced "roadmap" of changes necessary to create the integrated delivery system envisioned in the HEA amendments. Systems requirements will be grouped into systems modules that will be acquired in logical sequence. The blueprint aims to validate the work done to date through Project EASI, revise it where necessary, and fill the gaps.

To be certain the future system adequately addresses the needs of external users, we are collaborating on the blueprint with students, institutions, and financial partners during its development.

Dealing with Y2K computer systems issues is also major effort within OSFA. As of March 1999, all OSFA student aid systems have undergone upgrades to address Y2K problems, completed independent verification and validation (IV&V) by a third-party contractor, and are being fully implemented. During the rest of FY 1999 and in FY 2000, we are pursuing our IV&V contractor's recommendations for continued documentation and monitoring procedures, carrying out tests with external customers and partners, and making contingency plans to deal with any breakdowns in the overall aid delivery system.

A key driver in our modernization strategy will be maximizing the number of transactions that can be done electronically using the Internet. Electronic transactions significantly reduce processing costs and error rates. The Free Application for Federal Student Aid (FAFSA) costs us 45 percent more to process in paper form than electronic form. Error rates average 12 to 14 percent for paper applications compared to one percent for electronic ones.

The benefits of electronic processes have also been documented in the lending industry. Recent data from the Federal Reserve, based on surveys of member banks, show that electronic applications for installment loans cost less than $2 each, compared with more than

$40 for paper applications. Electronic payments cost about $0.12 each, while non-electronic payments cost more than $2 each.

In conjunction with the modernization blueprint, we are developing entirely new acquisition strategies intended to lower costs and improve contractor performance. These include:

- Using performance-based contracts in all major new awards;
- Utilizing new procurement flexibilities included in the Higher Education Amendments, including modular contracting, two-phase source selection; and fee-for-service arrangements, under which the Department would be billed based on transactions processed;
- Using existing commercial systems, rather than building new OSFA systems to carry out commercially available services;
- Recruiting new staff, and tapping contract management expertise from other Federal agencies, to help the PBO take full advantage of its new procurement flexibilities; and
- Providing improved training in contract management to all managers and staff involved in contract oversight.

Developing the integrated Title IV delivery system described in the PBO legislation will require significant up-front investments. These will yield outyear savings per item processed as old systems are eliminated and new ones brought on-line. Because our blueprint for modernization of computer systems is not yet complete, and because of the rapid changes taking place in information technology, nobody could make good estimates of the costs or savings associated with systems modules that will be designed more than two years from now. As detailed designs for initial system modules are developed, we will estimate and report on the cost to develop them and any savings expected to result.

Enhanced Financial Management. The Department has made progress on its financial systems, receiving an unqualified opinion

on its FY 1997 financial statements and, with its FFEL partners, dramatically improving the quality of financial data in the National Student Loan Data System. In the process, OSFA identified major challenges that must be achieved to meet best-in-business standards and its mandate to reduce costs and improve accountability. For our managers to have reliable information to measure costs and performance and to inform management decisions, major improvements in our financial management systems are needed. For example:

- We do not have automated systems balancing and reconciliation processes, and must manually reconcile our $34 billion in annual transactions.
- We cannot consolidate information across Title IV programs to track total funding. This is needed to monitor trends, performance, and minimize the potential for fraud and abuse.
- We cannot produce useful management reports to monitor our loan portfolio because we do not have timely and complete records of loan transactions.
- Our financial systems do not measure the costs of administrative activities except at the aggregate annual appropriation level. To measure cost performance against certain key benchmarks used in the private sector (e.g., cost to administer a loan), we will need to develop new cost accounting systems and processes.

Responsibility for some of these problems is shared by OSFA and its FFEL partners. More work is needed to ensure that data provided to the Department by our partners is timely, accurate, and complete.

Because we lack the financial management software and processes now prevalent in the private sector, there is a huge gap between our practices and those of industry. Our financial management staff spend over 90 percent of their time processing payments and performing basic financial operations using outmoded systems.

Resources have not been allocated to date for data analysis to measure performance, manage risk, and support budget decisions.

By comparison, recent data published by PricewaterhouseCoopers shows that over the past three years, major corporations spend only 24 percent of their financial management resources on financial operations. This is expected to drop to 18 percent over the next three years. Industry financial offices devote significant resources to data analysis activities related to performance monitoring, risk management, and financial and investment strategy.

By investing in high-end financial management software and systems now used by industry, we can move from heavily manual systems to highly automated ones. These investments will ultimately reduce errors and administrative costs for OSFA and its partners.

Human Resource Plan. The Higher Education Amendments included several provisions to make the PBO's personnel processes more flexible: (1) authority to appoint such senior managers as necessary; (2) authority to hire up to 25 excepted service positions, using streamlined recruitment procedures; (3) elimination of all ceilings on employee grades and numbers; and (4) authority to work with the Office of Personnel Management to develop alternative staffing, classification, and pay structures.

We are now actively seeking candidates for professional and technical positions in the excepted service. We expect to bring in experts from private industry for some of our senior information technology and financial management positions. In addition, to help reinforce OSFA's focus on our ultimate customers, we are greatly expanding efforts to recruit student interns.

We are working to develop a new organizational structure organized along three lines, or channels, that deal with students, institutions, and financial partners. The current organization is a mix of programs and functional areas. Private sector corporations often align their organizations around customer and partner needs and preferences in each channel, ensuring that processes are re-engineered with these needs in mind.

Our success depends on our employees, most of whom were part of the PBO when it was created last fall. With employee involvement, we will develop a human resource and organizational plan that incorporates the elements described above, and identifies what other changes are needed to help employees work more productively. We anticipate making significant investments in two related areas—facilities improvements and staff training—to create an organizational environment where employees can perform effectively and efficiently.

Facilities Improvements. About 700 of our employees work in the Washington office in overcrowded conditions at our 7th and D Street, Southwest, location. Available space for these employees is one-third less than the Department's workstation standards. Independent tests have documented air quality problems, and employees have had to move from hazardous areas. Problems with aging plumbing and insulation and peeling paint add to the difficulties. Cramped and dingy conditions undermine staff morale and our ability to recruit highly qualified personnel.

We have begun working with the General Services Administration on a plan to get more space and renovate it to bring it up to the same space standard that exists for other Federal agencies. Preliminary plans indicate the project will cost about $28 million spread over a three-year period. The Department considered moving OSFA to another location to deal with the crowding and quality issues, but renovation of the current location will save roughly $10 million compared to a relocation.

Staff Training. The changing demands on OSFA as a PBO require additional investments to be made in upgrading employee skills. High performing private sector organizations routinely invest in high quality training of their staffs. Andersen Consulting, now assisting OSFA with its transition to a PBO, spends 8 percent of its annual operating budget on employee training. By comparison, we spent less than 1 percent of our 1997 and 1998 operating budgets for training. Training in use of information technology, customer service, and contract management is critical to creating a modern, customer-focused organization to deliver student aid.

CONCLUSIONS

1. We face major challenges in making the transition to a PBO and addressing the objectives set forth in legislation. We envision dramatic changes in our systems and processes to improve service and reduce costs. Such changes must be accomplished without interrupting services to students, schools, and financial institutions. Within the operating budget available for FY 1999 and requested for FY 2000, we have sufficient funds to begin making improvements to meet these challenges.

2. The PBO legislation's mandate to reduce costs must be viewed in the context of overall Federal spending on the Title IV programs. A narrower view could measure success based solely on reductions in Federal administrative costs. Doing so would be short-sighted if such reductions resulted in even greater federal costs elsewhere in the Title IV system. In allocating future administrative resources, we must take steps to minimize losses from default, fraud and error, and to promote continuous improvements in service and cost-efficiency in the highly subsidized Title IV system.

3. The dramatic workload increases anticipated in future years pose a serious challenge. While we are fully committed to significantly improving our cost-efficiency through systems redesign, reliable estimates of costs to create an integrated system and the savings that will result cannot be known for some time. Once the modernization blueprint is in place, with detailed requirements for initial systems modules, cost estimates can be made for the first phases of modernization. Without accurate outyear estimates for other systems modules, however, we cannot provide details of how we will achieve the savings needed to manage rising workload within the flat funding levels now projected for FY 2001 through 2004.

4. In keeping with the intent of the PBO legislation, Congress and the Administration may want to consider alternative funding approaches that link future OSFA funding to workload, using appropriate unit cost benchmarks. This is not an immediate priority of OSFA, but may become more important if the constraints of the current budget structure jeopardize our capacity to meet our performance targets in the face of workload increases. Work now underway – to build a track record on performance and to develop cost accounting systems to measure costs – builds the foundation needed for serious exploration of alternatives in the future.

Appendix A:
Automated Data Processing Activities

As shown in the table below, the Office of Student Financial Assistance (OSFA) will spend $407 million in FY 2000—or 61 percent of its overall budget—on private-sector data processing contracts to operate the systems that deliver, account for, and collect Federal grants and loans.

OSFA ADP Contract Operations Costs (In millions of dollars)

	1999	2000
Direct Loan Origination and Consolidation	$33.0	$32.6
Direct Loan Servicing and Central Data Base	154.2	232.5
Subtotal, Direct Loans	187.2	265.1
Central Processing System	25.8	28.5
Multiple Data Entry	20.1	21.3
Subtotal, Application Processing	45.9	49.8
Virtual Data Center	28.6	34.5
Public Inquiry Contract	15.0	17.3
National Student Loan Data System	11.8	15.8
Title IV Wide-Area Network	14.5	14.6
Stafford-Perkins Data Services	9.0	2.0
Recipient and Financial Management System (Pell)	6.3	5.0
Campus-Based Management Information System	1.5	2.3
Postsecondary Education Participants System	2.4	0.6
Year 2000	3.1	0
Total	325.3	407.0

These processing activities include:

- **Direct Loan Origination and Consolidation ($32.6 million in FY 2000).** This contract originates Direct Stafford and PLUS Loans and Direct Consolidation Loans. Loan origination costs are expected to remain essentially unchanged from FY 1999 to FY 2000. Electronic Data Systems, Inc. (EDS), in Montgomery, Alabama, is the Direct Loan origination and consolidation contractor.

- **Direct Loan Servicing and Central Database ($232.5 million).** This contract provides loan servicing support, maintains the Department's database of Direct Loan recipient and payment information, handles billings and repayments, and assists with customer service. This contract is also responsible for linking information from the loan origination and servicing systems and providing the subsidiary ledger for Direct Loans. FY 2000 costs for this contract will increase by $78.3 million over FY 1999, as the number of Direct Loans on the servicing system grows by 25 percent, from 13.5 million to 17.0 million. Affiliated Computer Services, Inc (ACS) of Rockville, Maryland, has been the sole Direct Loan servicer since the beginning of the program, and will continue to service new and existing loans for at least the next few years.

- **Multiple Data Entry (MDE) and Central Processing System (CPS) contracts ($49.8 million).** These contracts provide data entry and processing for approximately 10 million applications for Federal student aid each year, determining student eligibility and award levels and passing the information on to students, parents, and schools. The cost of these contracts is expected to increase by $3.8 million from the FY 1999 level, primarily as a result of anticipated increases in application volume and annual increases in contracted production deliverable costs. The multiple data entry contract is held by the American College Testing Service in Iowa City, Iowa, and Mt. Vernon, Illinois. National Computer Systems (NCS) in Iowa City, Iowa, is the central processing contractor, as well as the designated alternate data entry site.

- **Virtual Data Center ($34.5 million).** This contract provides centralized computer processing services, including all hardware and system software necessary to support the Title IV programs. NSLDS, PEPS, RFMS, and Campus-Based are the systems that have been moved to the Data Center at this time. OSFA expects the following systems to make the transition in FY 1999: the central processing system, Direct Loans origination and central database, and Stafford/Perkins data services. All OSFA data processing is expected to be done by the Data Center at the end of FY 2000. This function is provided under a GSA contract with Computer Services Corporation (CSC) of Meriden, Connecticut.

- **The Public Inquiry Contract (PIC) ($17.3 million).** This contract maintains the Federal Student Aid Information Center that provides toll-free telephone service (1-800-4FED-AID) for the public to obtain information concerning Federal financial assistance to students. The PIC is also an integral component of the Department's default collection system, serving as the borrowers' first point of contact with the Department to check balance information, and preparing responses to written requests or arranging repayment terms. In FY 1999, the system will respond to almost 5 million telephone inquiries and generate more than 600,000 pieces of correspondence. These volumes are expected to increase over the next few years. The request for this contract reflects a $2.2 million—or 15.0 percent—increase in funding over FY 1999. Additional costs result from anticipated volume increases related to having the PIC phone number on the first page of the FAFSA directions, the implementation of Lifetime Learning tax credits, and new initiatives included in the reauthorization of the Higher Education Act, as well as the incorporation of enhanced customer service features. This contract is held by National Computer Systems in Iowa City, Iowa, and Lawrence, Kansas.

- **The National Student Loan Data System (NSLDS) ($15.8 million).** NSLDS is a 1.5 billion-record database that includes 93 million loans and over 15 million Pell Grants. The system provides loan- and grant-level information to support program audits, accounting, and program reviews. In addition, schools use NSLDS to screen student aid applicants to identify borrowers who are in default, have reached statutory loan limits, or are otherwise ineligible to receive Federal student aid. NSLDS is also the Department's data source for calculating cohort default rates in the FFEL and Direct Loan programs. NSLDS costs for FY 2000 are expected to increase by $4.0 million from the FY 1999 level, largely due to an ongoing effort to improve data quality and reasonability, as well as scheduled increases in production deliverable costs. The current contractor for NSLDS is Raytheon E-Systems, Inc., in Greenville, Texas. The Department transferred the NSLDS processing activities to the Virtual Data Center in February 1998. Moving these activities to the lower-priced CSC facility is expected to save a minimum of $5 million per year in reduced processing costs.

- **The Title IV Wide-Area Network (TIV-WAN) ($14.6 million).** This contract supports electronic telecommunications linking lenders, guaranty agencies, and schools with the Department's information and application processing systems. OSFA plans to construct an Enterprise Gateway in FY 1999 that will take advantage of internet technology for most data transmissions. The Enterprise Gateway also will provide a single translator for multiple transmission protocols, such as Electronic Data Interchange, simplifying communications among OSFA program participants. Costs for this contract are expected to remain basically unchanged from the FY 1999 level. This contract is held by National Computer Systems (NCS) in Iowa City, Iowa.

- **Stafford/Perkins Data Services ($2.0 million).** This contract processes payment claims from lenders and guaranty agencies and is the Department's primary system for default collection activities. These collection efforts have yielded impressive results: total collections have more than doubled—from $1 billion to more than $2 billion—from FY 1993 to FY 1998. Perkins Loans represent roughly 10 percent of estimated costs under this contract. Contract costs for FY 2000 are expected to decrease by $11.9 million from the FY 1999 level, largely as a result of expanded use of electronic interfaces and the anticipated shift of processing activities to the Virtual Data Center. This contract is held by Raytheon E-Systems, Inc., in Greenville, Texas.

- **The Recipient and Financial Management System (RFMS) (formerly the Pell system) and Campus-Based Management Information System contracts ($7.3 million).** These contracts will obligate and track almost 7 million Pell Grant and campus-based awards in FY 1999. This system is used to distribute and monitor grant funds to institutions and students. The RFMS system is being redesigned in FY 1999, in this case to build upon common origination and disbursement concepts such as Just-in-Time processing. Costs for these contracts are expected to decrease by $0.5 million from FY 1999 to FY 2000 as the RFMS redesign effort is completed. These contracts are held by Affiliated Computer Services, Inc. (ACS), of Rockville, Maryland, and United Automation Labs of Silver Spring, Maryland, respectively.

- **The Postsecondary Education Participants System (PEPS) ($633,000).** This contract supports the Department's program integrity efforts by providing software development and supporting detailed information on all institutions participating in Federal student aid programs, as well as other programs authorized under the Higher Education Act. Costs for FY 2000 reflect a $1.8 million reduction from the FY 1999 level; savings reflect the anticipated completion of system development activities. This contract is held by Computer Business Management, Inc. (CBMI) of Fairfax, Virginia.

Appendix B: Obligations by Object Classification (in millions of dollars)

	1999				2000			
	Program Admin.	FFEL	HEA Section 458	Total	Program Admin.	FFEL	HEA Section 458	Total
Full-Time Permanent	$19.4	$20.7	$33.6	$73.7	$20.5	$21.7	$35.6	$77.8
Overtime	0.1	0.0	0.1	0.2	0.1	0.0	0.0	0.1
Awards	0.3	0.3	0.9	1.5	0.2	0.3	1.0	1.5
Benefits	4.2	4.4	7.0	15.6	4.5	4.8	7.5	16.8
Subtotal, Personnel	24.0	25.4	41.6	91.0	25.3	26.8	44.1	96.2
Travel	1.1	0.6	3.2	5.6	1.1	0.8	3.7	5.6
Transportation	0.0	0.5	0.3	0.8	0.0	0.1	0.1	0.2
Rent to GSA	0.0	2.3	5.5	7.8	0.0	2.3	5.5	7.8
Communications	0.7	0.0	8.7	9.4	0.8	0.0	10.6	11.4
Postage	0.0	0.7	27.2	27.9	0.0	0.7	28.6	29.3
Printing	2.4	0.1	6.2	8.7	0.0	0.5	9.2	9.7
Advisory & Assistance	0.0	0.0	3.5	3.5	0.0	0.0	10.9	10.9
Other Services	3.7	1.3	11.8	16.8	5.7	1.1	7.5	14.3
Training	0.2	0.3	4.0	4.5	0.5	0.4	6.3	7.2

Appendix B: Obligations by Object Classification (in millions of dollars) -- (continued)

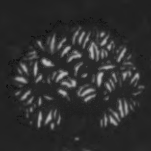
	1999				2000			
	Program Admin.	FFEL	HEA Section 458	Total	Program Admin.	FFEL	HEA Section 458	Total
Goods/Services from Government	$0.4	$1.2	$2.3	$3.9	$0.1	$1.7	$2.7	$4.5
Operations/Maintenance of Facilities	0.0	0.0	0.0	0.0	0.2	0.0	0.0	0.2
Operations/Maintenance of Equipment	0.0	0.0	0.1	0.1	0.0	0.0	0.4	0.4
ADP Contracts	24.6	14.3	316.0	354.9	24.6	12.8	410.0	447.4
Supplies	0.3	0.1	0.4	0.8	0.1	0.2	0.8	1.1
ADP Equipment/Software	0.5	0.5	0.9	1.9	0.3	0.4	1.1	1.8
Other Equipment	0.1	0.0	0.1	0.2	0.1	0.1	1.3	1.5
Building Alterations	0.0	0.0	8.0	8.0	0.0	0.1	12.2	12.3
Payments to Guaranty Agencies	0.0	0.0	177.0	177.0	0.0	0.0	180.0	180.0
Total	58.0	47.3	617.5	722.8	58.8	48.0	735.0	841.8
FTE	346	368	571	1,285	346	368	571	1,285

OSFA welcomes comments on this budget plan. Comments may be directed to Kathy Stack at:

e-mail: kathy_stack@ed.gov

phone: 202-260-6536

mail: 400 Maryland Avenue S.W.
ROB-3
Room 4004
Washington, DC 20202-5132



Office of Student Financial Assistance

BEST COPY AVAILABLE